Federal Home Loan Bank System

Federal Home Loan Bank Board

Office of Community Investment

Cooperative Housing

FHL 1.6/2:

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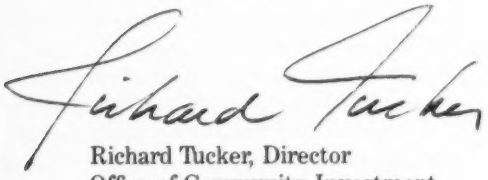
Lenders developing Community Investment Programs are discovering that a variety of methods exist for revitalizing their communities. Getting enough information about these methods, though, is often difficult.

The Office of Community Investment has prepared this pamphlet on *Cooperative Housing* both to provide some basic data on the subject and to point the direction where more detailed information can be found.

As with other pamphlets published in this series by the Federal Home Loan Bank Board, this is not a complete "how-to-do-it" manual. Rather, it is an invitation to lenders to take a fresh look at a profitable method of housing finance which might have been overlooked before.

We hope you will enjoy reading it. We welcome your comments and would appreciate your suggestions on topics for future pamphlets.

This pamphlet could not have been produced without the generous assistance of many individuals, principally the Presidents of the District Banks, their Community Investment Officers and the Bank Board's Office of Communications.



Richard Tucker, Director
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Introduction

In recent years, interest in cooperative housing has increased markedly throughout the country. As mortgage rates climb and the housing market tightens, more and more Americans are considering coops as a means of purchasing affordable housing. Indeed, because of lower downpayments and monthly costs, coops can offer housing at costs lower than comparable condo or rental units.

Local governments and community groups are considering cooperatives as one way to prevent urban displacement. Increasingly, apartment dwellers in urban areas face the conversion of their rental units into condominiums at prohibitively high acquisition prices. Such condo conversion has a heavy impact on elderly, minority and low-income renters. Coops, on the other hand, offer an alternative which allows residents to remain in their homes and neighborhoods and gain the same tax and ownership advantages as condos.

Coops are not a new concept. Housing cooperatives were first organized in the United States in the early 1900's. Many coops — in cities such as New York and Chicago — are 40 to 50 years old and are still operating efficiently despite many changes in membership. In the past few years — in cities such as Milwaukee, Minneapolis and Baltimore — cooperatives have become an important strategy in reversing the decline of mature neighborhoods and in rehabilitating dilapidated older homes and apartment buildings. In rural areas, cooperatives have been organized to help low-income farm workers purchase single-family homes.

The lending industry has a strategic role in the development of cooperative housing throughout the country, since adequate financing is the key element in the organization of many cooperatives. Some thrifts have been involved in coop lending for many years, providing blanket

loans on the land and buildings owned by cooperatives; others have entered the coop lending market more recently, as a modern method of fulfilling their traditional role of home financing. Across the country, thrift institutions have joined in partnerships with city governments and non-profit citizen groups to underwrite and fund housing cooperatives. Many lenders recognize that a well-managed coop can reduce some of the risks associated with conventional rental investment, such as turnover rates and collection losses.

Recognizing cooperative housing as a growing homeownership trend, the Federal Home Loan Bank Board has made several changes in its regulations which facilitate lending on housing coops by Federally-chartered thrifts. Other actions by Congress also should pave the way for increased financing for coops. For example, the National Consumer Cooperative Bank has been established and recent statutory changes authorize the Federal Home Loan Mortgage Corporation and Federal National Mortgage Association to purchase share loans on coop units.

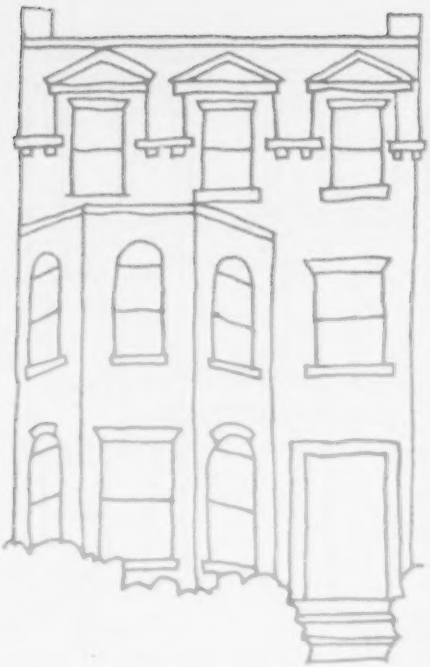
Lenders, then, should assess the potential of housing cooperatives as a part of their investment strategy. Coops offer lenders another way of stimulating both urban and rural housing investment while pursuing safe, sound and profitable lending opportunities.

Coops and Community Investment

The financing of cooperative housing offers the thrift industry an excellent means of stimulating community revitalization and investment. Coops meet a diversity of homeowner needs. Cooperative ownership is an attractive alternative for many first-time homebuyers and for renters wanting to become homeowners. An estimated 41 million Americans will reach home-buying age in the 1980's. Unfortunately, as land and contruction costs rise, many families cannot afford to purchase a new single-family home. Competition for existing housing is driving prices beyond the reach of most families. However, many borrowers, who would not otherwise be able to obtain a conventional home mortgage, can qualify for a coop unit loan.

Because most coops have a long term mortgage and are governed by the members, attention is given to controlling management costs and reducing monthly charges. These cooperatives are attractive and economically viable for many credit-worthy families, who could not otherwise afford homeownership because of high monthly mortgage payments. By keeping down monthly shelter costs, some low-and moderate-income families can use cooperative housing as an interim step to save for subsequent non-coop home purchase. Coops also are a significant housing option for many middle- and upper-income people as well. Owners of market-rate coops can accumulate equity toward the subsequent purchase of the single-family home. Some coop memberships are structured in ways which offer significant investment opportunities. Coops offer owners the benefit of income tax deductions on interest and depreciation.

Some coop by-law arrangements give the coop owner major responsibility for maintenance and other upkeep of the unit. However, other coop arrangements take care of all upkeep and maintenance matters, as part of the monthly charge; this arrangement is welcome to many people, especially the elderly, who prefer apartment living. As mutual owners, coop members have the security of being able to remain in their homes as long as they wish and they may have fewer of the many maintenance and other chores necessary in a single family home.



Community Stability and Displacement

Cooperatives are a good investment for thrifts concerned with the revitalization of mature neighborhoods and the maintenance of property values. Coops offer greater housing opportunities to low- and moderate-income and elderly and handicapped tenants.

A well-maintained cooperative building can have a positive impact upon its surrounding neighborhood. Often there is a sharp reduction in vandalism and other destruction, when a building is converted from rental to cooperative units. As property owners, the building residents take greater responsibility for and pride in the up-keep of the building. The cooperative association is responsible for major repairs, insurance, replacement of worn out equipment (and often appliances) and upkeep of common grounds and facilities, which generally assures a decent level of maintenance throughout the coop.

In a number of cities, cooperatives are being organized as a way of revitalizing and stabilizing troubled urban neighborhoods, as well as a means of preventing the displacement of low-income families and senior citizens from neighborhoods undergoing revitalization. Coops have lower residential turnover rates than rental properties and therefore make a contribution to neighborhood stability similar to conventional single-family homes. Frequently, tenants organize cooperatives in response to the threat of condominium conversion or in dissatisfaction with landlord neglect.

Beecher Cooperative — in the middle income Glover Park section of Washington, D. C. — is one example where apartment residents joined together to purchase their buildings as a defense against condominium displacement. In addition to a mortgage loan from a S&L, the coop used local and Federal funds to rehabilitate the buildings and to assist existing elderly and low-income tenants who wanted to become members of the coop.

Approximately one-half of the states have enacted statutes that provide various types of protection for tenants and buyers in conversion of condominiums and cooperatives. A few states have passed legislation to preserve a certain level of low- and moderate-income housing stock. Most of this restrictive legislation has been directed at condominiums, since many city officials recognize conversion of rental properties into cooperatives is a way of encouraging neighborhood revitalization and reinvestment in many urban areas.

In the past year, the U.S. Congress has expressed a great deal of interest in the issue of conversion of rental buildings into condominiums and cooperatives. The 1980 Housing and Community Development Act contained a "sense of Congress" resolution, Section 603, which stated that "lending by Federally insured institutions for the conversion of rental housing to condominiums and cooperative housing should be discouraged where there are adverse impacts on housing opportunities of the low- and moderate-income and elderly and handicapped tenants involved."

In Baltimore, cooperatives have been used as a revitalization technique in joint developments through Neighborhood Housing Services projects and private, non-profit efforts. Washington Hill and Reservoir Hill are two areas where scattered-site coops have rejuvenated older townhouse neighborhoods. Chatham Park Village, in Chicago, is another excellent example of the use of cooperative housing to stabilize a community. For over ten years, Chatham Park Village has functioned as a successful, integrated, inner-city cooperative.

Thrifts, which have acquired ownership of rental properties, can use coop conversion as a way of rehabilitating the property. Thrifts can help tenants to form their own cooperatives or can work with a public housing authority or local community group to acquire and rehabilitate rental properties as cooperative housing.

Rural Development

Cooperative housing can be an important revitalization and stabilization tool in rural areas as well. About 60% of the nation's substandard housing is in rural areas and minorities occupy about one-third of it. Often rural farmworkers and migrant workers face displacement, when farm owners decide to eliminate farmworker housing and evict the tenants.

In upstate New York, 25 low-income rural families banded to-

gether to form Hope Village Inc., A Cooperative Community, so as to be able to purchase new single-family homes financed by Farmers Home Administration 515 (b) loans. Many of the Hope Village residents originally were migrant farm workers; to gain better jobs and educational opportunities, they wanted to settle permanently in the area. The Housing Assistance Council loaned them interest-free seed money used for land acquisition and technical assistance. And with HAC's encouragement, a memorandum of understanding was initiated between HUD and FmHA to make HUD Section 8 subsidy assistance available for eligible families in FmHA-financed coops. This arrangement extends to all other coops as well.

Another example of a rural farm worker housing cooperative is Cabrillo Village, an old migrant worker community near Ventura, California. The tenants, some of whom had lived there for 20 years or more, organized themselves and with the help of a local group were able to buy the property. Now the cooperative is rehabilitating the older housing and building new low-income units with the help of Farmers Home Administration funds and the Housing Assistance Council. The result has been a substantial improvement in housing and the opportunity for homeownership for these workers.

Organizing Cooperatives

Knowledge of some basic information about the financing and organization of cooperatives will be useful to thrifts in their participation in the cooperative housing market.

Housing cooperatives are complicated organizations with which most people are unfamiliar. The term "cooperative" may have several different meanings. It may indicate an organization which has been incorporated under a state cooperative corporation statute, or that a corporation is entitled to tax treatment as a cooperative, or simply that an organization is operating "cooperatively." Housing cooperatives function as participatory democracies. They are controlled by the member occupants. Each coop member has one share-vote, regardless of the amount of money they have invested in the cooperative. Cooperative by-laws require the active participation of the members in the governance of the coop association and require the management and cooperative board of directors to disclose to the members all important financial and management matters. Also, most well-organized cooperatives require members to receive formal training about the operation of the cooperative at the beginning of their membership and at periodic intervals thereafter. Aside from these basic characteristics, there are many ways in which cooperatives may formally be structured and operate.

Independent, market-rate cooperatives usually are organized as membership associations or stock corporations which hold title tc the property. Many independent coops offer their shares at full-market value and shares are resold either by individual unit owners or through the coop corporation. Although a professional manager may be hired and supervised by the members, each independent cooperative depends upon its own members and board for management and operation. Independent, market-rate cooperatives have operated most successfully with middle- and upper-income families, who tend to have greater financial resources to devote to property operation and more personal experience in management and leadership necessary for coop governance.

A second type is the **limited equity cooperative**. In a limited equity arrangement, the coop organization, through its by-laws, places a limit on the amount of dividend, if any, paid on funds invested in the coop and also restricts the amount of return allowed when shares are sold.

Most limited equity cooperatives do not allow shares to be sold at full market value. The coop corporation retains the right or option to repurchase and resell the shares of resident members either at the original value or with only modest or limited appreciation in equity returns. This limitation is intended to keep the cost of buying into the cooperative from rising with inflation and speculative pressures. The bulk of equity is accumulated by the coop organization and maintained as reserves for major coop expenditures. Limited equity cooperatives usually have lower monthly carrying charges than market rate or condo units, which make them an attractive housing option for both middle- and low-income purchasers. Low income, limited equity coops may be organized with government financial aid, either through the HUD Section 8 program or with below-market rate financing from a state or local housing agency. Such subsidies help members purchase shares and meet monthly carrying charges. Some city housing agencies are developing limited equity coops as a means of combating displacement and of providing families an opportunity to move out of public housing and into homes they could not otherwise afford to own.

Leasing cooperatives are a useful

way of providing low- and moderate-income housing. In this arrangement, the coop organization leases or rents the buildings from the owner-investor, who can then take advantage of tax shelter laws. The leasing agreement also may include a fee to the coop organization for its services as manager of the buildings. At the end of the lease, the property may be sold to the coop. A public entity — such as a housing authority — may use the leasing arrangement to retain ownership of the buildings in order to hold unit prices at below-market rates and maintain the availability of such low-cost units in urban areas, while giving management responsibility to the leasing coop association. Some leasing coops use resident management to reduce operating costs and to give the residents an increased sense of responsibility for the care of the property. In the case of privately-owned properties, the owner can hire a professional manager to attend to day-to-day operations.

Differences Between Cooperatives and Condominiums

Coops and condominiums have many operational similarities, but there are unique characteristics in both ownership forms. Both cooperatives and condominiums are a form of multiple co-ownership. The fundamental difference is that cooperatives are a form of group homeownership, whereas condominiums are a form of individual homeownership. Condominium owners have a fee simple interest in the real estate, with absolute and clear title to their individual units, generally with an unrestricted right to sell or lease their property, as they wish. In cooperatives, the buildings are owned by a corporation; the tenant-shareholders own a share interest — either stock or a membership — in the proprietary lease which entitles them to occupy their living units. By virtue of membership in a condo association, condo owners are co-owners of the common areas, open space and any improvement. Coop members also are co-owners of such common areas by virtue of their share interest.

Financing Coops

Until recently, a major difference between coops and condos was the availability of financing from Federal lending institutions. However, changes in the Bank Board's regulations and the development of a secondary market should place cooperatives on a par with condominiums and other forms of homeownership for conventional financing.

Bank Board Regulations Dealing with Cooperatives

In 1978, Congress passed legislation which gave Federal associations explicit statutory authority to make loans secured by individual shares in cooperative housing projects. To implement this authority, the Federal Home Loan Bank Board revised its regulations to include cooperatives under the definition of "single family dwelling," which already had been interpreted to apply to condominiums. These regulations permit loans on individual coop unit shares to be made on the same terms as loans on condominiums or single-family dwellings, up to 95% of the value of the security property, and liberalized requirements for blanket loans which formerly were limited to 80% of appraised value. Now blanket loans can be made up to 95% of the value of the whole coop project. However, if a lender is providing both the blanket loan and individual share loans for the same coop, the total amount of financing on any one unit is limited to 95% of the appraised value of the blanket loan obligation attributable to that unit.

Recently, the Bank Board has made other changes in the regulations affecting coops. One change removes the requirement for presale of units equal to 90% of the value or purchase price of the coop, but retains the requirement for reserves "at least equal" to those required of developments insured under FHA. Also, the first-lien requirements for both the blanket loan and share loans on individual coop units have been eliminated. This change was necessary because many coop by-laws require that the corporation retain a first-lien on each share to protect against the non-payment of monthly carrying charges.

The consumer lending authority, which was authorized for thrifts under the 1980 Depository Institutions Deregulation and Monetary Control Act, also applies to coop lending. Like commercial banks, thrifts can provide consumer loans for coop unit purchase. Thrift associations will be able to choose between offering borrowers either a consumer or a real estate loan on a individual coop unit. Thus lenders will be able to fit interest rates and terms to the borrower's needs and existing market conditions. However, coop real estate loans will offer consumers the greater benefit of 30 year terms and lower payments.

Coops As Real Property: The Bank Board has recognized the unique distinction between real and personal property which is present in the cooperative arrangement. State laws in California, Minnesota, New Jersey and Colorado have recognized cooperative unit ownership as a real

estate interest under state law. However, in most states, laws define cooperative shares as personal property and not real estate. All thrifts interested in coop lending, whether Federally or state chartered, must carefully check the real estate and tax laws in their own states which affect cooperatives.

Coop Lending Requirements: Coop lending generally is the same as conventional real estate lending, but a distinction must be made between the requirements for lending to the coop organization and making individual unit loans. Two different security instruments are commonly used for cooperative loans. **Blanket loans** are used to finance the acquisition of land and buildings and for improvements on the entire cooperative project. These are issued to the coop organization and are secured by a mortgage interest in the real estate. Real estate lenders will find little difference between the blanket mortgage instrument for a cooperative project and for other types of multi-family housing projects. **Individual real estate, commercial or consumer loans** are made to the coop stockholders or members for purchase of shares of stock or a membership certificate. Under Bank Board rules, individual share loans must be secured by two legal documents: 1) a security interest in the stock and/or membership certificate, and 2) by an assignment of the borrower's interest in the proprietary lease or occupancy agreement. The Bank Board considers both the blanket and individual share loans as real estate loans. However, the Bank Board's recognition of the individual coop share loan as real estate does not alter the need for lenders to make certain that all state laws regarding necessary security instruments are met.

The ability of thrifts to make individual share real estate loans gives them greater flexibility in dealing with growing coop investment opportunities. Lending to coops also may

have other advantages. Often the coop corporation and the individual members will place their operating accounts and savings with the lending institution.

Underwriting Coop Loans

For many lenders, coop lending is a new challenge which requires careful study. Although there is substantial lender experience with blanket loans covering an entire project, only a limited number of thrifts — mostly in New York, Maryland and California — have been originating loans on individual coop units. Because of the differences between coop unit loans and other types of loans on single-family homes, some lenders have been adapting the instruments and appraisal procedures used in underwriting condominium units for use in coop underwriting. The appraisal of individual units in a coop is much the same as appraisal for a single-family home loan or for a condominium, where the rights of ownership and the amenities included must be specified.

To protect their interests, lenders should be aware of any local or state laws pertaining to taxes, subdivision, recording priorities, financing and sales which must be blended into the lending documents. A current survey and a location plan of the living units and other areas, such a parking spaces, is desirable to enable title insurance companies to issue policies protecting both the lender and the coop corporation.

- **Coop Blanket Loans**

In assessing an application from a coop organization for a blanket loan, the lender must make a feasibility analysis and a market appraisal much like underwriting any other income-producing real estate project. However, the lender should be aware of several factors which make coop project mortgages slightly different from other conventional mortgage loans. When assessing the risk of underwriting a blanket loan for a particular coop association, lenders must consider factors such as the coop's organization, management, financial reserves, leadership strength and the desire of the members to preserve their property.

Lenders should make certain that at least 80% of the coop's income is from its resident members since this is required for the real estate and mortgage interest tax deductions under Section 216 of the Internal Revenue Code. The lender's interest could be jeopardized if the coop earns income from other sources which violates this rule.

For their own protection, lenders must be sensitive to the different assessment factors which must be weighed in dealing with newly organized coops and those which have been in operation for a few years. A new coop association, seeking permanent financing for acquisition and rehabilitation of buildings or for new construction, usually does not have a record of credit and existing loan obligations. Therefore, the lender must assess the strength of the coop's proposed financial structure and reserves. Established coops with existing mortgages have a credit record and a history of operation which the lender can review in assessing credit-worthiness. Whether the coop is new or old, the lender must take a hard look at the leadership capability of the coop's board of directors to make certain that it functions re-

sponsibly and has the wholehearted support of the membership.

In reviewing any loan application from a coop, whether for an initial blanket mortgage or refinancing, the lender should pay attention to such factors as the length of time the coop has been in existence, membership turnover rate, equity participation and income to housing expense ratio, as possible indicators of the stability of the coop organization, its membership turnover and its loan repayment capability. Also, the lender should assess the credit standard used by the association in reviewing applications for membership. If an individual shareholder defaults on monthly payments, the coop must make up the difference either from its reserves or from among the other shareholders. The coop should give the lender information on the number of members, if any, who are behind on their monthly payments. This provides an indication of the financial health of coop reserves and of the coop association's management strength. The lender should inquire about the length of the coop's applicant waiting list and its membership review and selection procedures. A rule of thumb is that a good waiting list should be about three times the annual turnover rate, should be updated through regular contact with the applicants and should be backed by an application deposit. With new coops, lenders should assess the ability to attract new tenants and to retain existing tenants in a converted building as essential elements of success.

The coop's management procedures are extremely important in determining the association's ability to repay a blanket loan. The lender should review the coop corporation's by-laws and meet with its legal counsel to find out how the coop corporation's board of directors is elected and held accountable by the members; how often it meets; how it formulates necessary long and short-range management plans, and how it communicates decisions and needs to the coop membership. Often in negotiating a loan, lenders arrange to have a representative attend board meetings on a regular basis. Some lenders even have a seat on the coop board.

The lender should find out if the coop has the assistance of a professional development or management organization or if it employs a full-time manager. While the greatest strength in a cooperative is the active involvement of the members in management decisions, professional management assistance often helps inexperienced coop members to better understand better their responsibilities. Strong management insures that the affairs of the coop are handled efficiently, that adequate financial reserves are maintained and that monthly fees are set at levels which cover necessary present and future costs. A requirement that all members participate in a training course in coop management gives assurance that all the members are aware of their rights and responsibilities to actively participate in coop decision-making.

The coop should have a written management plan and operating procedures which outline the steps needed to maintain the financial and physical condition of the property. In an existing cooperative, the lender can assess the effectiveness of the management over a period of time. However, in newly organized coops, the lender must assess prospective performance on the basis of written procedures and proposed management plans. A good management plan should include procedures for member recruitment and screening, collection of monthly fees, bookkeeping, reporting, dispatching and analyzing service requests, purchasing, preventive maintenance, emergency responses and other major elements of efficient management. The ability of a coop to repay its loan will depend in large part on management performance which assures maximum occupancy and maintains expenditures for maintenance and administration within reasonable limits, thereby assuring an adequate cash flow to service the loan.

- **Individual Coop Loans**

Lenders have several alternative ways of handling individual coop unit loans. Unit loans can be second-trust on the project loan, a 30-year mortgage, or a consumer loan. However, certain elements are common to all of these approaches. The lender should receive a deed of trust or assignment of the leasehold interest or right of occupancy of the owner. The borrower's membership certificate should be delivered to the lender along with a blank endorsement or "stock power" to be held as security during the term of the loan. Under the Uniform Commercial Code, possession of the stock or membership certificate is a prerequisite to perfect the lender's security interest in the coop share. In some cases, under the UCC, a financing statement also may be filed with the state. In addition, the lender may require a letter from the coop board of directors or manager assuring notification should the share borrower fall behind in payment of monthly service fees and face action by the coop board.

In the case of default on an indi-

vidual coop unit loan, eviction of the tenant from the unit — not foreclosure — is the lender's recourse. Lenders may conclude a formal agreement with the coop corporation which defines the rights and responsibilities of each in the event of default on a share loan. Frequently, coop by-laws give the corporation the right of first refusal or first option to purchase. Also, many coops require that unit purchasers be pre-approved for membership by the coop board. Depending upon the coop's by-laws, the lender may sell the stock or membership certificate at public or private sale (after proper notice to the borrower and the cooperative association) and concurrently assign the proprietary lease to the purchaser. Good communication between the lender and the coop management will alert both to any difficulties which may be arising with individual unit borrowers.

The Secondary Market for Coop Loans

At present, some types of blanket mortgages for coops are being purchased in the formal secondary market. As coop lending increases, secondary market opportunities for both blanket and single unit loans also should grow.

The Federal Home Loan Mortgage Corporation (FHLMC) can purchase blanket loans on coops under its current multi-family program. FHLMC is exploring the development of a program for the purchase of coop share loans, but some changes must be made in the Internal Revenue Code before it will be feasible to initiate this program. A bill has been introduced in Congress, S. 885, S. 885, to amend sections 593, 7701, and 856 of the Internal Revenue Code, so that coop loans can be bought and sold in the secondary market. FHLMC would hope to finance its purchases of loans on cooperative units through its participation certificates. In order to sell participation certificates to savings and loan associations, mutual savings banks and other savings associations, all loans that are put into pools backing a participation certificate must be considered as "secured by an interest in real property" and "qualifying real property loans" under certain sections of the Internal Revenue Code, so that the associations can avail themselves of the unique tax treatment that is given to them under the Code. The Treasury Regulations that implement one of the provisions (Section 593, relating to reserves for bad debts) make it clear that the law of the state in which the property is located determines whether a particular type of property will be considered real property. In most states, coop shares are treated as personal property, rather than real property.

At present, the Federal National Mortgage Association (FNMA) does not purchase single unit loans on cooperatives. FNMA does purchase blanket loans on FHA-insured, multi-family coop projects, but not on conventional multi-family coops. In the 1980 Housing Act, Congress authorized FNMA to purchase unit loans.

The Government National Mortgage Association (GNMA) administers the Section 8 (Program 25) and Targeted Tandem (Program 27) "Tandem Plan" programs. Under Program 25, GNMA issues a commitment to purchase the loan for a Section 8 assisted project before work is begun, thus encouraging a private lender to provide construction financing on the assurance the GNMA will purchase the permanent loan when construction is completed. Program 27 — Targeted Tandem — can be used for any HUD/FHA-insured non-Section 8 multi-family project in a UDAG-designated city. Under these two Tandem programs, GNMA purchases the loans at 97.5% of par with a 2% commitment fee and then sells the loans to private investors at a price which reflects the current market yield. GNMA also has a mortgage-backed securities program which can be used for coops; GNMA guarantees a security which is backed by the HUD/FHA loan. The security then is sold to a private investor to raise capital for the housing being financed.

The National Consumer Cooperative Bank already is negotiating with lenders to provide a secondary market for coop blanket loans. The Bank also is considering the possibility of a secondary market for individual share loans insured under HUD 203(n).

Private mortgage insurers and state mortgage insurance programs also offer secondary mortgage market facilities for coop blanket loans. Lenders in the Northeast and Middle West have found a ready market for blanket loans with insurance companies which regard coops, like other conventional income properties such as apartments, as an excellent investment. Coop loans can be packaged like other real estate loans for sale through conventional mortgage pass-through certificates or by pooling into mortgage-backed securities for sale in the capital market. Lenders should check with their state insurance agency concerning insurance for coops under single-family programs.

Federal Assistance to Cooperative Formation

The major Federal assistance programs for constructing, organizing and subsidizing cooperative housing are operated by the Department of Housing and Urban Development and by the Farmers Home Administration, United States Department of Agriculture, for urban and rural cooperatives respectively.

Some government programs available for home financing cannot be used for cooperatives. The Veterans Administration, for example, does not guarantee loans for the purchase of coops because a first lien on the mortgage is required for all VA assistance. However, legislation has been introduced in Congress (HR2038) to authorize VA to make coop membership loans.

HUD Programs

HUD offers several FHA mortgage insurance programs to facilitate the construction, rehabilitation, and refinancing of housing cooperatives, as well as a direct subsidy assistance program for buyers. These are as follows:

Section 213 of the National Housing Act authorizes HUD to provide mortgage insurance on pre-sale management and investor sponsored cooperative housing projects of five or more units for construction, substantial rehabilitation, conversion or re-financing. Section 213 does not provide for non-profit sponsorships. For new construction, Section 213 will insure up to 98% of the estimated replacement cost of the cooperative building. For substantial rehab, Section 213 will insure up to 98% of the amount based upon the estimated cost of rehabilitation plus the "As Is Value" or acquisition cost or existing mortgage indebtedness against the property before rehabilitation. Under Section 213(i) the maximum insurable mortgage can be up to 97% of the appraised value of the building for continued use as a coop. Only previously insured existing construction of projects built prior to September 23, 1959, which do not require substantial rehabilitation, are insurable under Section 213(i). Under 213(j), a supplementary loan insurance program is available for financing coop improvements, repairs and community facilities, and for the purchase of memberships by the coop corporation.

Sections 221(d)3 and (d)4 of the National Housing Act also supply mortgage insurance at FHA ceiling rates to finance new construction or substantial rehabilitation of pre-sale non-profit or investor-sponsored cooperative housing. Section 221(d)3 mortgages also are available to local housing authorities serving as public agency mortgagors for Section 8 assisted housing. HUD may insure up to 100% of the loan under (d)3, but only 90% under (d)4. Section 221(d)4 also provides for limited dividend partnerships at 90%. Below market interest rates and rent supplements are no longer available for new projects under these programs.

Section 203 (n) of the National Housing Act provides mortgage insurance financing to individuals who are purchasing corporate certificates and occupancy certificates offered for resale in existing cooperative projects which are covered by a HUD-insured blanket mortgage. The maximum mortgage amount is $67,500, but this amount may be increased by up to 20% for the installation of a solar energy system. The maximum mortgage amount may also be increased up to 95% of the median one-family house price for the area, in geographical areas where high sales prices have restricted housing opportunities for moderate- and middle-income persons. The amount of mortgage insurance is also limited to 97% of the first $25,000 of appraised value (100% for qualified veterans) and 95% of the appraised value in excess of $25,000. This program should be of greater use to thrifts now that they can make single unit loans. A handbook on 203 (n) is available from the HUD field offices.

Section 207 of the National Housing Act provides mortgage insurance to cooperative mobile home park mortgagees, using Section 213 procedures.

The Section 8 Housing Assistance Payments Program has been used to subsidize the monthly carrying charges of lower-income participants in cooperative housing projects. The tenant pays between 15% and 25% adjusted family income and HUD Section 8 subsidy makes up the difference to meet the monthly carrying charges. At the initial determination of eligibility, the income of the household may not exceed 80% of the area median income. Under Section 8 new construction assistance, the cooperative may enter into an assistance contract for any or all of the units. However, if GNMA Program 25 is to be used, between 20% and 100% of the units must be set aside for Section 8 subsidy and 90% occupancy by assisted tenants must be maintained in the units set aside. When HUD agrees to provide Section 8 assistance to a cooperative project, there is a requirement that a certain proportion of the units be maintained for Section 8 households to insure the availability of housing for low-income families. It

is important for thrifts to be aware of the usefulness of Section 8 in maintaining a proportion of low-income units in middle-income cooperatives. This program has been a major factor in the success of coop anti-displacement strategies used in many cities.

FmHA Programs

Section 515(b), Rural Cooperative Housing Loan Program authorized FmHA to make loans for rural housing cooperatives. Presently, FmHA Instruction 444.7, which covers use of this program for coops, is cumbersome; however, FmHA is rewriting and consolidating these regulations to specifically address the unique issues relating to rural coops and has requested comments from specific organizations on the proposed changes. The 515 program provides direct construction loans for new projects with no restrictions on amounts or cost per unit, so long as costs are consistent with area construction costs; however, FmHA has published square foot restrictions on the size of 515 units. HUD Section 8 or FmHA rental assistance subsidy can be used with 515(b).

The National Consumer Cooperative Bank

The National Consumer Cooperative Bank promises to be a major new source of credit, financial and technical assistance to existing and emerging consumer cooperatives, including housing coops. The Bank was established in 1979 to make loans to eligible cooperatives operated on a non-profit basis at market interest rates. The Bank also offers interest supplement and self-help development loans. Of interest to thrifts is the fact that the Bank is investigating ways of providing a secondary mortgage market for both blanket and individual unit loans to cooperatives. On a case by case basis, the Bank will review applications for purchase of existing coop share loans.

The Future of Cooperative Investment

Renewed interest in coops as an alternative to condominium and conventional single-family ownership is likely to spark greater demand for coop loans in the future. The thrift industry has the opportunity to be in the forefront of this new lending market.

The following brief examples illustrate how thrift institutions around the country have participated in coop housing loans. Some of these loans were made in the regular course of business, others represent a conscious commitment by the thrift to try new forms of community lending and find ways to better meet the needs of low- and moderate-income borrowers. Many have done so through use of the Community Investment Fund (CIF).

American Savings and Loan, Beverly Hills, CA, (Assets: $9.5 billion), has been involved in underwriting loans in single coop units as a result of a 1978 change in California law which allows loans for individual units in a coop building. American has adapted condominium documents for use on coop loans and has set up documentation which follows Section 3.207 of FHLMC's Sellers/Servicers Guide. The documents were prepared to meet all of FHLMC's requirements for the secondary market on condominiums, in anticipation of a second market opportunity for coop single unit loans. American has made more than 100 loans on stock cooperative units, with a loan-to-value ratio of 60% for 30 years and an original dollar amount of more than $10 million.

First Federal Savings and Loan Association, Boston, MA, (Assets: $180.4 million), is making share loans on individual units in the Kenmore Towers Cooperative. The Kenmore is a 111-unit luxury apartment which was organized by the tenants in cooperation with a local real estate developer. All of the units were sold within three days of conversion, at an average price of $70,000. The coop conversion was financed with a blanket mortgage of $2.3 million, $3 million in individual applications for unit loans and $1.7 million from other lenders for a cash downpayment. The existing FHA-insured mortgage on the building was assumed by the coop corporation. First Federal expects to underwrite about 75% of the unit loans on the building at an interest rate about one percent above the going condominium rate.

Midwest Federal Savings and Loan Association of Minneapolis, (Assets: $1.6 billion), has been very active in coop lending and has closed $4.2 million in coop housing blanket loans and has $12 million in process. Most of these loans are for rehabilitation of coop conversions. Midwest Federal is involved in negotiations with the National Consumer Cooperative Bank for financing of a $4.2 million interim loan which Midwest has made for the acquisition and construction of four separate coops. Midwest received a tentative commitment from the Bank for a 90% participation.

Santa Barbara Savings and Loan Association, Santa Barbara, CA, (Assets: $1.7 billion), has committed $150,000 in CIF funds initially to finance the acquisition and rehabilita-

tion of a limited equity coop and may authorize a total of $250,000 at final closing, if needed. Additional funds are from private loans and from a HUD innovative grant to the city for use in cooperative housing, which is administered by the Santa Barbara Community Housing Corporation.

When construction is completed, at the second closing, the project will receive $351,000 in HUD Section 312 funds and $240,000 in city loans. The buildings consist of 16 units in single-story wooden frame structures which are being renovated into 13 single-family units of one, two and three bedrooms. All the units were vacant at acquisition, so no relocation or displacement occurred. Tenants for the housing will be selected and referred by the local public housing authority; seven families will be low income, eligible for Section 8 assistance and six families will be moderate income (up to $22,000 for a family of four). The families participating in this limited-equity coop will be expected to do some improvements themselves, such as painting, fencing and landscaping, for which part of the downpayment price will be used to purchase materials. Families will pay from $3,051 to $5,563 per unit purchase price, with monthly charges from about $353 to $534, which is lower than the monthly cost of similar rental units.

Santa Barbara S&L became involved in the project because one of the officers was serving on a city neighborhood revitalization task force. The Association was interested in the project because of the inadequate supply of medium priced homes in Santa Barbara and the severe lack of affordable housing for middle, moderate and low income people. The Santa Barbara Housing Authority views coops as a way of moving low-income public housing families toward self-sufficiency and homeownership.

Midland Federal Savings and Loan Association, Denver, CO, (Assets: $876 million) is assisting the

Denver Housing Authority by arranging financing of three FHA-insured loans on housing coop projects. All of the loans are being packaged for resale to GNMA under Tandem Programs 25 and 27. In cooperation with the Denver Housing Authority, Midland is providing a loan of $25 million for a 350-unit limited equity coop building to be constructed in 1981. Shares in the coop will be valued at between $45,000 and $65,000, 80% of the unit shares will be marketed at $3,000-$5,000, the other 20% of the units will be for Section 8 assistance at a buying price of $500 per share. The Denver Housing Authority hopes to use this coop to help public housing families at the upper income levels move toward homeownership.

Perpetual-American Federal Savings & Loan Association, Washington, DC, (Assets: $1 billion), loaned 80% of the purchase price for the buildings of Beecher Cooperative, a loan of $1,040,000 for 30 years at market rate. Beecher was organized by the tenants of an apartment complex which was threatened by condominium conversion. With the help of a coop development firm, the tenants organized a limited partnership which owns the buildings and leases them back to Beecher Cooperative, Inc., as a managing general partner. This arrangement uses a commercial "net" lease in which all operating decisions and costs for the upkeep of the property are the responsibility of the lessee.

Beecher Coop has the option to buy the property at the end of the six-year lease and upon the sale of the buildings will be paid 50% of the proceeds as compensation for its activities as general partner, an arrangement which effectively reduces the cost of acquisition by half the market value. In addition to the loan from Perpetual-American, Beecher received about $11,000 in rehabilitation financing from the D.C. Department of Housing and Community Development, using CDBG funds.

Two questions had to be resolved in creating Beecher: 1) How could tenants making an average of $8,500 afford the $4,000 per unit acquisition and closing costs? 2) How could tenants paying $150 per month rent afford a coop monthly cost of $330? These questions were solved by a combination of the leasing arrangement for purchase, government funding assistance and arrangement for Section 8 monthly subsidy assistance for 40% of the units.

Perpetual-American also made a $691,000 loan for 30 years at market rate to the tenants of Tel Court Cooperative in Southwest Washington. Funds for the acquisition and renovation of Tel Court's buildings were provided by Savings Associations Financial Enterprises, Inc. (SAFE), a service corporation for Washington based S&L's. Many of Tel Court's tenants were low-income, black, and elderly. Many of these tenants had lived for 20 years or more in their apartments and were faced with displacement by condominium conversion. Again, D.C. Housing Agency funds, CDBG, and HUD Section 8 assistance were used to make the project feasible.

The Empire Savings, Building and Loan Association, Denver, CO, (Assets: $1 billion), is working with the Denver Community Development

Agency and the Urban Coalition to develop a cooperative housing finance package and a low-income housing coop project which will serve as models for future projects in Denver. Empire has indicated its interest in providing a blanket loan of $350,000, if matching funds of $200,000 are made available from HUD and private grants, to purchase a 32-unit, one-bedroom apartment building. Empire is using the Community Investment Fund to underwrite a portion of the loan, and is investigating the feasibility of a co-origination with the National Consumer Cooperative Bank to reduce the interest rates on the package. The Urban Coalition will interview the existing tenants in the building — most of whom are low-income elderly — to determine if a sufficient number wish to participate in the housing cooperative. Preliminary estimates put the cost of a single coop unit at $17,800. A limited-equity coop will be organized and there will be an effort to limit the share participation cost to existing tenants to about $500 per unit, making up the rest of the downpayment from grants. Tenants will sign over their leases as part of the deed of trust. Great care is being taken in the formulation of the legal and financial instruments and particularly in planning the organization and management of the cooperative. Both Empire and the city agency are concerned with providing technical assistance to the coop members and in the organization of the coop board of directors to make certain that there is sufficient expertise and training during the first years of operation to ensure efficient management.

First Savings Association of Wisconsin, Milwaukee, WI, (Assets: $1.1 billion), has been involved in lending to housing cooperatives since 1962, when it made a loan of $2.5 million for construction of a new coop building. Much of First Savings' current coop activity is a result of the working relationship its branch offices have established with community groups in their service areas. One branch has worked with a community group to purchase some duplexes which now are rented but are being organized as a coop. First Savings wrote separate construction loans for each building so that the current market value on the building after rehabilitation would cover the rehab costs and reduce the initial cash outlay of the coop association. A savings account was opened and the carrying charges on the two mortgages were made from the interest. Another branch is participating with a consortium of ten lenders to finance cooperative developments organized by a neighborhood group and has made several loans of $15,000 and $20,000 to two other groups for acquisition and rehabilitation of scattered site duplexes to be used as housing coops.

A Glossary of Important Housing Coop Terms

The **Cooperative Corporation By-laws** spell out the individual member's relationship and obligations to the corporation. Also, the by-laws specify the duties of the corporation's board of directors — elected by the stockholders from among their members — for example: establishing an annual operating budget, making property improvements and authorizing other major maintenance expenditures for the corporation. The by-laws specify the transfer value and other procedures relating to sale of a membership certificate or stock.

The **Membership Certificate** is the certificate of ownership in the cooperative corporation. Membership certificates are used in some coops instead of stock certificates.

The **Occupancy Agreement** — sometimes called a Proprietary Lease — is the contract between each member and the corporation, which gives the member an exclusive right to occupy a unit, to participate in government of the corporation and to receive tax benefits and equity increases in return for financial and personal support of the corporation. The occupancy agreement usually is for a specified number of years and is automatically renewed if the member is not in violation of the rules adopted by the board of directors and is not given notice to leave by the board.

The **membership certificate** and the **occupancy agreement** together provide the security for a loan on an individual cooperative housing unit.

A **Subscription Agreement** is the document used to sell a membership in a cooperative.

The **Proportionate Share** is the percentage an individual unit's value represents of the total valuation of the project at the time the cooperative corporation takes title to the property. This percentage, which remains attached to each unit, determines the share of the corporation's annual operating budget to be charged the member living in the unit. Each cooperative resident pays a proportionate share of the costs; if there is a budget surplus, each member receives a "patronage refund" proportionate to the share paid. Each member also is entitled to

declare a proportionate share of cooperative real estate taxes and mortgage interest on personal income tax statements. If the legal documents of the cooperative are properly structured, the Internal Revenue Service will allow the individual unit owners to deduct from their taxable income a pro-rata portion of the corporation's real estate taxes and any blanket mortgage interest paid by the corporation, this is an advantage not available to renters. If the cooperative is dissolved and all of the assets sold, the share members in occupancy at the time receive a proportionate share of proceeds remaining after all outstanding obligations have been paid.

Resource List

FEDERAL OFFICES

National Consumer Cooperative Bank
2001 S Street, N. W.
Washington, D. C. 20009
(202) 376-0500
Contact: Housing Division

Department of Housing and Urban Development
4517 7th Street, S. W.
Washington, D. C. 20410
(202) 426-7191
Contact: Coop and Condo Branch

Farmers Home Administration
South Agriculture Building
Washington, D. C. 20250
(202) 447-7207
Contact: Multi-family Housing Division

NATIONAL COOPERATIVE HOUSING ASSOCIATIONS

Community Associations Institute
3000 South Eads Street
Arlington, VA. 22202
(703) 548-8600
Contact: Doug Kleine

Co-op Foundation
1821 University Avenue
St. Paul, MN 55104
(612) 646-1160
Contact: Thomas F. Ellerbe, Jr., President

Foundation for Cooperative Housing
2501 M Street, N.W., Suite 450
Washington, D. C. 20037
(202) 887-0700
Contact: Jessie Jones, Vice President and Coordinator of Domestic Projects

National Association of Housing Cooperatives
1012 Fourteenth Street, N. W., Suite 805
Washington, D. C. 20005
(202) 628-6242
Contact: Tom Stitt, Director

United Housing Foundation
465 Grand Street
New York, N. Y. 10002
(212) 673-3900
Contact: George Schechter, Administrative Director

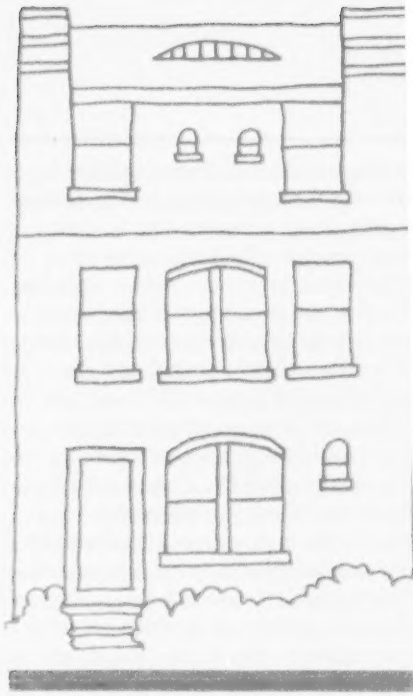
REGIONAL COOPERATIVE HOUSING ASSOCIATIONS

California Association of Housing Cooperatives
300 Valley Street, Suite 301
Sausalito, CA 94765
(415) 332-7021
Contact: Lydia Joseph, Executive Director

Cooperative Services, Inc.
7404 Woodward Avenue
Detroit, MI 48202
(313) 874-4000
Contact: Fred Thornthwaite

Eastern Cooperative Housing Organization (ECHO)
4530 West 62nd Street
Brooklyn, OH 44144
(216) 252-3571
Contact: Ben Lecorherek

Federation of 213's
138-10 Franklin Avenue
Flushing, N. Y. 11355
(212) 353-5080
Contact: Charles Rappoport



Midwest Assn. of Housing Cooperatives (MAHC)
343 S. Main Street, Suite 208
Ann Arbor, MI 48104
(313) 994-4314
Contact: Debby Locke, Executive Director

Mitchell-Lama Council
2823 West 12th Street
Brooklyn, N. Y. 11224
(212) 449-8443
Contact: Murray Raphael

NASCO
Box 7293
Ann Arbor, MI 48107
(313) 663-0889
Contact: Shiela Ritter

Plains Assn. of Housing Co-ops
3208 Hardesty Drive
Kansas City, MO 64128
(816) 923-1651
Contact: Helen Herndon

Potomac Assn. of Housing Co-ops
8403 Dixon Avenue, Suite 3
Silver Spring, Md. 20910
(301) 589-5450
Contact: Edward Jesse

Southeast Assn. of Housing Co-ops
405 Fairburn Road, S. W., #94
Atlanta, GA. 30331
(404) 588-3865
Contact: Marlene Cooper

FHLB Presidents and Community Investment Officers

DISTRICT 1

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David Elliott, Vice President
Director of Community Investment

Federal Home Loan Bank of Boston
One Federal Street, 30th Floor
Boston, Massachusetts 02110
617/223-5300

Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont

DISTRICT 2

Bryce Curry, President

David Dennison, Vice President
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Federal Home Loan Bank of New York
One World Trade Center, Floor 103
New York, New York 10048
212/432-2000

New Jersey, New York, Puerto Rico and Virgin Islands

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Thomas Jones, Vice President
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Federal Home Loan Bank of Pittsburgh
11 Stanwix Street
4th Floor, Gateway Center
Pittsburgh, Pennsylvania 15222
412/288-3400

Delaware, Pennsylvania, West Virginia

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Carl O. Kamp, Jr., President

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Federal Home Loan Bank of Atlanta
Coastal States Building
260 Peachtree Street, NW
Atlanta, Georgia 30303
404/522-2450

Alabama, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina and Virginia

DISTRICT 5

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Carol Braddock, Vice President
Community Investment Officer

Federal Home Loan Bank of Cincinnati
2500 DuBois Tower
Cincinnati, Ohio 45202
513/852-7500

Kentucky, Ohio and Tennessee

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2900 Indiana Tower
One Indiana Square
Indianapolis, Indiana 46204
317/269-5200

Indiana and Michigan

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Federal Home Loan Bank of Chicago
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Chicago, Illinois 60601
312/565-5700

Illinois and Wisconsin

DISTRICT 8

Dean R. Prichett, President

Joseph F. Egan
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Federal Home Loan Bank of Des Moines
907 Walnut Street
Des Moines, Iowa 50309
515/243-4211

Iowa, Minnesota, Missouri, North Dakota and South Dakota

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Federal Home Loan Bank of Little Rock
1400 Tower Building
Little Rock, Arkansas 72201
501/372-7141

Arkansas, Louisiana, Mississippi, New Mexico and Texas

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Richard Fischman, Vice President
Community Investment Officer

Federal Home Loan Bank of Topeka
120 East 6th Street
Topeka, Kansas 66603
913/233-0507

Colorado, Kansas, Nebraska and Oklahoma

DISTRICT 11

Milton Feinerman, President

Lydia Bundy, Vice President
Community Investment Officer

Federal Home Loan Bank of San Francisco
600 California Street
San Francisco, California 94120
415/393-1000

Arizona, California and Nevada

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Addis Chapman, Vice President
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U.S. GOVERNMENT PRINTING OFFICE : 1981 O - 346-934

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